Supreme Court, U.S.
FILED
APR 20 1977
MICHAEL RODAK, JR., CLERK

No. 76-1085

In the Supreme Court of the United States

OCTOBER TERM, 1976

TELEPHONE ANSWERING SERVICE CO., INC., ETC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

WADE H. McCREE, JR.,
Solicitor General,

MYRON C. BAUM,
Acting Assistant Attorney General,

ERNEST J. BROWN,
Attorney,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1085

TELEPHONE ANSWERING SERVICE CO., INC., ETC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. App. 1a-21a) are reported at 63 T.C. 423. The opinion of the court of appeals (Pet. App. 24a-25a) is not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on November 8, 1976. The petition for a writ of certiorari was filed on February 4, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether gain realized by petitioner upon its sale of the stock and obligations of a subsidiary corporation

resulted in taxable income to petitioner because it did not distribute all of its assets "in complete liquidation" within the meaning of Section 337 of the Internal Revenue Code of 1954.

STATUTE INVOLVED

The pertinent provisions of Section 337 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at Pet. 3.

STATEMENT

During 1965 and 1966, petitioner operated a telephone answering service in the vicinity of Baltimore, Maryland, and its suburbs. Petitioner owned all of the stock of two subsidiary corporations that were also engaged in that business. The subsidiaries were Telephone Answering Service, Inc. ("Houston"), which operated in several areas in Texas, and North American Answering Service, Inc. ("North American"), which operated in various suburbs of Philadelphia, Chicago, and Cleveland. Petitioner provided management services to those subsidiaries, and they paid management fees to it (Pet. App. 2a-5a).

After receipt of an inquiry concerning the possibility of sale of the stock of Houston, and preliminary negotiations to that end, petitioner's directors and stockholders in May, 1966, approved a document entitled "Plan of Complete Liquidation and Dissolution of Telephone Answering Service Company, Inc.," and also approved a contract for the sale of the stock and obligations of Houston. This sale took place in October, 1966, and petitioner realized a gain of $268,994.85 (Pet. App. 5a-6a).

In the interim, petitioner had organized another wholly-owned subsidiary corporation ("New Tasco") that subsequently adopted petitioner's name. In March, 1967, petitioner conveyed to New Tasco all of its assets except the stock of North American, the stock of New Tasco, and

slightly less cash than had been realized on the sale of the stock and obligations of Houston. Upon receipt of these assets, New Tasco assumed petitioner's obligations. In April, 1967, petitioner distributed to its shareholders the stock of New Tasco, the stock of North American, and the cash it had retained (Pet. App. 5a, 6a-7a). New Tasco, whose stock, after the April distribution, was wholly owned by petitioner's shareholders, continued the telephone answering service without interruption in the vicinity of Baltimore and its suburbs that had been operated by petitioner, in the same manner, with the same customers, the same facilities, and (with one exception) the same employees (Pet. App. 8a-9a).

On its consolidated federal income tax return for its taxable year ended November 30, 1966, petitioner reported gain from the sale of the stock and obligations of Houston, but claimed that the gain was not taxable under the non-recognition provisions of Section 337 of the Internal Revenue Code of 1954. On audit, the Commissioner determined a deficiency on the ground that petitioner's realized gain was taxable because "there was not a distribution of [petitioner's] assets in complete liquidation necessary to bring the sale within the nonrecognition of gain provisions of section 337" (Pet. App. 11a-12a).

In a reviewed decision (with three judges dissenting), the Tax Court upheld the Commissioner's determination because the transaction in this case did not meet the standard of a complete liquidation (Pet. App. 1a-21a). The Tax Court observed that a decision for petitioner "would frustrate the congressional purpose to deny section 337 treatment in connection with distributions of ongoing corporations" (Pet. App. 16a). The court of appeals affirmed, stating that it was "content to rest decision on the Tax Court's opinion" (Pet. App. 24a-25a).

ARGUMENT

The decision below correctly held that petitioner's sale of the stock and obligations of its subsidiary did not qualify for nonrecognition treatment under Section 337 of the Code. Under that provision, if a corporation adopts a plan of complete liquidation and within 12 months distributes all of its assets to its shareholders in complete liquidation, then no gain or loss is recognized to the corporation from its sale or exchange of property within the 12-month period. See *Central Tablet Mfg. Co.* v. *United States*, 417 U.S. 673, 677-683.

Petitioner recognizes (Pet. 6-7) that the courts have uniformly held that the requirements of Section 337 are not met if there is no distribution "in complete liquidation" of the corporation. Thus, where a corporation directly or indirectly transfers its assets to another corporation so that the enterprise continues in corporate form with continuity of stock ownership, resulting in a reorganization as defined by Sections 354 and 368 of the Code, with continuity in the basis of the assets provided by Section 362, there is no distribution "in complete liquidation" and Section 337 is inapplicable. See, *e.g.*, *Abegg* v. *Commissioner*, 429 F. 2d 1209 (C.A. 2), certiorari denied *sub nom. Cresta Corp., S.A.* v. *Commissioner*, 400 U.S. 1008; *Wilson* v. *Commissioner*, 46 T.C. 334, 352. See also *Pridemark, Inc.* v. *Commissioner*, 345 F. 2d 35, 41 (C.A. 4), reversing on other grounds, 42 T.C. 510.

Here, the Commissioner asserted in the Tax Court that the transfer of petitioner's operating assets to New Tasco was a "reorganization" as defined by Section 368 (a)(1)(D), and that under the uniform line of decisions referred to above, the transaction did not qualify as a liquidation under Section 337. Although petitioner argued

that New Tasco did not acquire "substantially all of the assets" of petitioner, as required by Section 354(b)(1)(A) for a reorganization defined by Section 368(a)(1)(D), the decisions likewise uniformly hold that the phrase "substantially all of the assets" refers to operating assets.[1] Since petitioner transferred to New Tasco "all of its directly-owned business assets" (Pet. App. 12a), the transaction involved "substantially all of the assets" within the meaning of the statute.

While the Tax Court did not specifically refer to the statutory reorganization provisions, except by way of the citations in its opinion (Pet. App. 17a), it pointed to the high degree of continuity in shareholder interest and in assets and operations between petitioner and New Tasco (Pet. App. 16a). In light of this continuity, it properly held that there was no complete liquidation under Section 337 and that to apply Section 337 to such an ongoing corporate relationship as was present in this case would frustrate the purpose of that provision (Pet. App. 13a-16a).[2]

---

[1]See, *e.g.*, *Moffatt* v. *Commissioner*, 363 F. 2d 262 (C.A. 9), certiorari denied, 386 U.S. 1016; *Reef Corp* v. *Commissioner*, 368 F. 2d 125, 131 (C.A. 5), certiorari denied, 386 U.S. 1018; *Babcock* v. *Phillips*, 372 F. 2d 240 (C.A. 10), certiorari denied, 387 U.S. 918; *DeGroff* v. *Commissioner*, 444 F. 2d 1385 (C.A. 10), affirming 54 T.C. 59; *James Armour, Inc.* v. *Commissioner*, 43 T.C. 295, 308-310; *Wilson* v. *Commissioner*, 46 T.C. 334, 345-348; *American Manufacturing Co.* v. *Commissioner*, 55 T.C. 204, 221-222.

[2]While we believe that the transaction between petitioner and New Tasco was a reorganization within the meaning of Section 368(a)(1)(D), and that this case could have been decided on that ground, reorganizations are not the only transactions that contemplate such continuity of ownership, operations, and basis as to be entirely antithetical to the complete liquidation required by Section 337. It is beyond dispute, for example, that whether or not the transaction between petitioner and New Tasco was a tax-free reorganization, it was

Contrary to petitioner's assertions (Pet. 6-10), the decision below does not conflict with *Commissioner* v. *Berghash*, 361 F. 2d 257 (C.A. 2), or *Breech* v. *United States*, 439 F. 2d 409 (C.A. 9). As the Tax Court pointed out (Pet. App. 16a-17a), those cases involved transfers of assets to corporations having such new and different stock ownership that there was no continuity of control, as defined by Section 368(c) of the Code. By contrast, though less than a significant number of shareholders redeemed their stock and withdrew from the enterprise (Pet. App. 8a-9a), all of the stockholders of New Tasco were stockholders of petitioner, and there was complete continuity of control.

---

a tax-free transfer of property to a controlled corporation within the provisions of Section 351, and that Section 362 provides the same continuity of basis for assets transferred pursuant to Section 351 that it does for assets transferred pursuant to a reorganization. Indeed, this Court has pointed out that Section 351 is closely related to the reorganization provisions, overlaps them in part, and fulfills many of the same functions. *Helvering* v. *Cement Investors*, 316 U.S. 527, 533-534. The question under Section 337 was whether petitioner distributed its assets in complete liquidation. The answer to that question, in the light of the continuation of petitioner's business in corporate form with beneficial interest remaining in substantially the same shareholders and with continuity of basis in the assets employed, must be in the negative, whether or not the Tax Court's opinion referred to one or another of the sections of the Code providing for corporate and tax continuity.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

WADE H. MCCREE, JR.,
Solicitor General.

MYRON C. BAUM,
Acting Assistant Attorney General.

ERNEST J. BROWN,
Attorney.

APRIL 1977.

DOJ-1977-04